University of Kentucky

UK HealthCare Hospital System
2016 Financial Statements

UK HealthCare Hospital System
An Organizational Unit of the University of Kentucky
Financial Statements
Years Ended June 30, 2016 and 2015

CONTENTS PAGE

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Independent Auditor's Report

Board of Trustees
University of Kentucky
UK HealthCare Hospital System
Lexington, Kentucky

We have audited the accompanying statements of net position of the UK HealthCare Hospital System (System), an organizational unit of the University of Kentucky (University), a component unit of the Commonwealth of Kentucky, as of June 30, 2016 and 2015, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended and the related notes to the financial statements, which collectively comprise the System's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis or our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the System as of June 30, 2016 and 2015, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements of the System are intended to present the financial position, the changes in financial position and cash flows of only that portion of the business-type activities that is attributable to the transactions of the System. They do not purport to, and do not, present fairly the financial position of the University as of June 30, 2016 and 2015, the changes in its financial position or its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis listed in the table of contents be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

BKD, LLP

Louisville, Kentucky
October 3, 2016

Management's Discussion and Analysis

The following Management's Discussion and Analysis, or MD&A, provides an overview of the financial position and activities of the UK HealthCare Hospital System for the years ended June 30, 2016 and 2015. UK HealthCare Hospital System includes Albert B. Chandler University Hospital, including Kentucky Children's Hospital (collectively Chandler); UK HealthCare Good Samaritan Hospital (Good Samaritan); and Kentucky Healthcare Enterprise, Inc. (KHE), a wholly owned for-profit subsidiary (collectively, the System). Management has prepared this discussion, and we encourage you to read it in conjunction with the financial statements and the notes appearing in this report.

About UK HealthCare System

UK HealthCare, a trademarked brand used by the University of Kentucky (the University) for its health care services, is uniquely equipped to provide advanced subspecialty care to the people of Kentucky. The academic medical center and health system provides patient care on par – in terms of both volume and complexity – with the nation's top 25 percent of academic medical centers. In August 2016, UK HealthCare was listed number one in Kentucky in the latest U.S. News Best Hospitals ranking. To be recognized as a best Hospital, UK HealthCare had to rank high nationally on a stringent data-driven ratings system that gauges performance. The analysis include multiple clinical specialties, procedures and conditions. Scores are based on a variety of patient outcome and care-related factors such as mortality and patient safety, as well as reputation. This and other notable achievements are listed at http://ukhealthcare.uky.edu/quality/awards/.

UK HealthCare Hospital System operates two hospital units under one Joint Commission Accreditation and two licenses in addition to ambulatory services. The major service units include Albert B. Chandler Hospital, Good Samaritan Hospital and the Kentucky Clinic. The System has a combined total of 825 licensed beds with an average daily census of 709 patients. On a monthly basis, the system provides over 1,222 inpatient surgeries, 1,388 outpatient surgeries, 32,638 radiology procedures, 9,035 emergency department visits, and 125,428 hospital based outpatient clinic visits.

Under a management contract entered into with the Kentucky Cabinet for Health and Family Services, UK HealthCare Hospital System also operates and manages Eastern State Hospital, a 300,000 square-foot facility located on the University's Coldstream Research Campus. The new psychiatric facility, opened in September 2013, provides a modern setting for both acute and long-term inpatient psychiatric treatment for adults living within Fayette County and the 50 surrounding counties.

UK HealthCare's Markey Cancer Center remains the state's only cancer center designated by the National Cancer Institute (NCI), which reflects the University's position as a frontrunner in cancer treatment and research. UK HealthCare is one of an elite group of only 22 medical centers in the United States that have NCI designation, a federally funded Center on Aging, and a highly prized Clinical and Translational Science Award grant.

UK HealthCare's dramatic growth within the last decade is in large part the result of a commitment to support the state's overall system of care by working hand-in-hand with local community providers to bring specialty care closer to the patient. These relationships take on different dimensions in each locality (management agreements, affiliate networks, outreach, etc.) and support keeping less acute care in the local community and smoothing the process for more complex, serious cases to be treated in UK HealthCare's Lexington facilities. The goal is better care at all points of the continuum.

Financial Highlights

The System's overall financial position remains strong with assets of $1.78 billion and liabilities of $688.4 million. Net position, which represents the System's residual interest in assets after liabilities are deducted, was $1.10 billion or 61.8% of total assets. For the fiscal year ended June 30, 2016, the System reported net income before other revenues, expenses, gains and losses of $100.9 million, generating a margin of 7.1%.

Financial results for fiscal year 2016 exceeded prior year revenues with net inpatient revenues, including the provision for doubtful accounts, increasing approximately $43.2 million or 5.6% over the prior fiscal year and net outpatient revenues, including the provision for doubtful accounts, increasing $51.1 million or 10.8% over the previous fiscal year. The change in net patient service revenue is primarily the result of increases in rates, an overall increase in the case mix index, improvements in payer mix and increased outpatient activity.

- Total assets increased $64.6 million or 3.8%. This increase is due to increases in capital assets, net of $51.6 million, cash and cash equivalents of $13.2 million, accounts receivable of $2.4 million, and inventories of $1.6 million,. This increase was offset by decreases in long-term investments of $3.0 million, other assets of $945,000, and notes receivable of $353,000.
- Deferred outflows of resources decreased $1.4 million, which represents the unamortized difference between the reacquisition price and the net carrying amount of the refunded debt.
- Total liabilities decreased $20.9 million or 2.9%, as a result of decreases of $15.0 million in long-term debt, $12.1 million in capital lease obligations, $5.1 million in other long-term liabilities and $3.6 million in unearned revenue. The decrease in long-term debt and capital lease obligations was due to $24.1 million in payments on outstanding debt and a $3.0 million net decrease in the amount due to the University of Kentucky. These decreases were offset by increases of $12.3 million in accounts payable and accrued liabilities and $2.7 million in estimated third-party settlements.
- Total net position increased $84.0 million or 8.3%, primarily due to the current year net income.
- Operating revenues increased $94.6 million or 7.1%, primarily due to an increase in net patient revenue of $94.3 million.
- Operating expenses increased $168.7 million or 14.9%, with all categories contributing to the increase. The largest increases were in supplies and personnel costs due to increased patient activity.
- The net nonoperating revenues decrease of $18.3 million primarily resulted from a $7.9 million increase in loss on disposal of capital assets, primarily due to the change in the equipment capitalization policy which resulted in a $7.4 million loss. Other contributing factors to the decrease in nonoperating revenues were a $7.0 million decrease in investment income, and a $2.4 million increase in interest expense. These were offset by a $1.3 million increase in gifts.

Operating Statistics

The following table presents utilization statistics for the System for fiscal years ended 2016, 2015 and 2014:

Discharges:	2016	2015	2014
Medicare	12,700	12,591	11,888
Medicaid	14,756	14,286	11,035
Commercial/Blue Cross	9,655	9,519	9,560
Patient/Charity	678	647	2,697
Total discharges	37,789	37,043	35,180
Average daily census	709.46	698	627
Average length of stay	6.87	6.78	6.50
Outpatient visits:			
Hospital clinics	501,943	479,782	428,582
Emergency visits	108,417	101,395	91,146
Total visits	610,360	581,177	519,728

2016. Total discharges increased by 746 or 2.0% compared to the prior fiscal year. The increase occurred primarily due to increases in Medicaid discharges of 470, Commercial/Blue Cross of 136 and Medicare of 109. Overall the Diagnosis-Related Group (DRG) case mix index increased to 2.0005 from 1.9270 and the average length of stay increased by 0.09 days to 6.87 days. The case mix for Chandler was at 2.1882 while Good Samaritan was at 1.3522. Total outpatient visits increased by 29,183 or 5.0% over the prior year.

Using the Financial Statements

The System presents its financial reports in a “business type activity” format, in accordance with Governmental Accounting Standards Board Statement (GASB) No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments* and GASB Statement No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities – an amendment of GASB Statement No. 34*. In addition to this MD&A section, the financial report includes a Statement of Net Position, a Statement of Revenues, Expenses and Changes in Net Position, a Statement of Cash Flows and Notes to the Financial Statements. GASB requires that statements be presented on a System-wide basis.

Reporting Entity

The System is an organizational unit of the University of Kentucky (the University), which is a component unit of the Commonwealth of Kentucky (the Commonwealth) and is included in the basic financial statements of the Commonwealth. The financial statements of the System include Kentucky Healthcare Enterprise, Inc. (KHE), a wholly owned for-profit subsidiary. The System provides inpatient, outpatient, and emergency care services for residents of the Commonwealth.

Statement of Net Position

The Statement of Net Position is the System’s balance sheet. It reflects the total assets, deferred outflows of resources, liabilities, and net position (equity) of the System as of June 30, 2016, with comparative information as of June 30, 2015. Liabilities due within one year, and assets available to pay those liabilities, are classified as current. Other assets and liabilities are classified as non-current. Net position, the difference between total assets, deferred outflows of resources, and total liabilities, is an important indicator of the System’s current financial condition, while the change in net position is an indicator of whether the overall financial position has improved or worsened during the year. Generally, assets, deferred outflows of resources, and liabilities are reported using current values. A major exception is capital assets, which are stated at historical cost, less accumulated depreciation. A summarized comparison of the System’s assets, deferred outflows of resources, liabilities, and net position at June 30, 2016, 2015 and 2014 follows:

Condensed Statements of Net Position (in thousands)

	2016	2015	2014
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES			
Current assets	$ 515,953	$ 445,260	$ 263,486
Capital asset, net	878,391	826,805	808,779
Other noncurrent assets	380,829	438,558	296,804
Deferred outflows of resources	10,946	12,368	-
Total assets and deferred outflows of resources	1,786,119	1,722,991	1,369,069
LIABILITIES			
Current liabilities	190,494	180,618	149,852
Noncurrent liabilities	497,860	528,623	397,500
Total liabilities	688,354	709,241	547,352
NET POSITION			
Net investment in capital assets	455,374	437,489	410,348
Nonexpendable other	195	119	118
Restricted expendable	11,902	10,538	10,331
Unrestricted	630,294	565,604	400,920
Total net position	$1,097,765	$ 1,013,750	$ 821,717

Assets. As of June 30, 2016, the System's total assets amounted to approximately $1.78 billion. Capital assets, net of depreciation, of $878.4 million, or 49.5% of total assets, represented the System's largest asset. Long-term investments of $268.7 million or 15.1% of total assets were the System's second largest asset. Accounts receivable, primarily patient-related, of $140.3 million or 7.9% represents another significant asset of the System. Cash and cash equivalents totaled $444.9 million or 25.1% of total assets.

Total assets increased by $64.6 million during the year ended June 30, 2016. The increase was the result of several factors: unrestricted and restricted cash increased $13.2 million from cash operating activities of $184.8 million and investing activities of $876,000, offset by decreases in cash from noncapital financial activities of $6.5 million and cash from capital and related financing activities of $166.0 million. Capital assets, net increased $51.6 million primarily due to construction projects, purchases of capital equipment, and software development. In addition, accounts receivable, net, increased $2.4 million, and inventories increased $1.6 million. These increases were offset by decreases in long-term investments of $3.0 million, other assets of $945,000 and notes receivable of $353,000.

Deferred Outflows of Resources. Deferred outflows of resources decreased $1.4 million, which represents the unamortized difference between the reacquisition price and the net carrying amount of the refunded debt. The System refunded General Receipts 2005 Notes Series A, and General Receipts 2007 Notes Series A and B during the fiscal year 2015.

Liabilities. As of June 30, 2016, the System's liabilities totaled approximately $688.4 million. Long-term debt (current and non-current), which consists of general receipts project notes and note payable to the University, comprised the largest liability of $445.9 million or 64.8% of total liabilities. Capital lease obligations totaled $44.8 million or 6.5% of liabilities. Current accounts payable and accrued expenses represented approximately $135.0 million or 19.6% of liabilities. Long-term liabilities, other, primarily unamortized bond premium, totaled $32.9 million or 4.8% of liabilities. Estimated third-party payer settlements were $22.8 million or 3.3%. Unearned revenue accounted for $7.0 million or 1.0%. Total liabilities decreased $20.9 million primarily due to $15.0 million principal payments on long-term debt and $12.1 million principal payments on capital lease obligations. In addition, unearned revenue decreased $3.6 million primarily because of a $2.8 million decrease in unearned revenue for Eastern State Hospital. Long-term liabilities, other decreased $5.1 million, primarily due to the $4.1 amortization of bond premium. These were offset by increases in, accounts payable and accrued liabilities of $12.3 million, primarily due to increases in payroll and vacation accruals and patient refunds. In addition, estimated third-party settlements increased $2.7 million.

Net Position. Net position at June 30, 2016 totaled approximately $1.10 billion, or 61.7% of total assets. Net investment in capital assets totaled $455.4 million or 41.5% of total net position. Restricted net position totaled approximately $12.1 million or 1.1% of total net position. Unrestricted net position accounted for $630.3 million or 57.4% of total net position. Total net position increased $84.0 million or 8.3%.

Restricted net position is subject to externally imposed restrictions governing its use. Although unrestricted net position is not subject to externally imposed stipulations, substantially all of the unrestricted net position has been internally designated for capital projects and working capital requirements.

2015 Versus 2014. When comparing the fiscal year ended June 30, 2015 to the year ended June 30, 2014:

- Total assets increased by $341.6 million during the year ended June 30, 2015. The increase was the result of several factors: unrestricted and restricted cash increased $320.0 million from operating activities of $263.7 million, noncapital financial activities of $15.0 million, cash from capital and related financing activities of $38.5 million and cash from investing activities of $2.8 million due to the endowment posting a gain of 1.5%. Capital assets, net increased $18.0 million primarily due to construction projects, purchases of capital equipment, and software development. In addition, accounts receivable, net, increased $15.7 million, inventories increased $6.7 million, long-term investments increased $2.8 million, notes receivable decreased $12.8 million, estimated third-party payer settlements receivable decreased by $6.5 million, and other assets decreased $2.3 million.
- Deferred outflows of resources increased $12.4 million, which represents the unamortized difference between the reacquisition price and the net carrying amount of the refunded debt. The System refunded General Receipts 2005 Notes Series A, and General Receipts 2007 Notes Series A and B during the fiscal year 2015.

- Total liabilities increased $161.9 million primarily due to increases in long-term debt of $110.1 million, long-term liabilities, other, $32.7 million and in unearned revenue of $21.2 million. These were offset by a decrease in capital lease obligations of $15.5 million.
- Total net position increased $192.0 million, primarily due to a net gain for the year related to net income from continuing operations.

Statement of Revenues, Expenses and Changes in Net Position

The Statement of Revenues, Expenses and Changes in Net Position is the System's income statement. It details how net position has fluctuated during the year ended June 30, 2016, with comparative information for the year ended June 30, 2015. This statement is prepared on the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged. All items that increase or decrease net position must appear on the Statement of Revenues, Expenses and Changes in Net Position as revenues, expenses, gains or losses.

Financial activities are reported as either operating or nonoperating. GASB Statement No. 35 requires state appropriations, gifts and investment income to be classified as nonoperating revenues. The utilization of long-lived capital assets is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

Condensed Statements of Revenues, Expenses and Changes in Net Position
(in thousands)

	2016	2015	2014
OPERATING REVENUES			
Net patient service revenues	$ 1,332,714	$ 1,238,392	$ 1,039,264
Sales and services	48,307	51,476	39,833
Management contract revenue	42,674	39,265	35,910
Total operating revenues	1,423,695	1,329,133	1,115,007
OPERATING EXPENSES			
Salaries and wages	385,834	343,872	306,265
Fringe benefits	111,343	98,101	87,533
Supplies	327,766	287,184	240,898
Purchased services	214,458	182,656	168,654
Other expenses	166,267	129,015	125,414
Depreciation	53,603	53,167	51,460
Management contract expenses	39,336	35,910	33,348
Total operating expenses	1,298,607	1,129,905	1,013,572
NET INCOME FROM CONTINUING OPERATIONS	125,088	199,228	101,435
NONOPERATING REVENUES (EXPENSES)			
State appropriations	1,053	1,053	1,053
Gifts and non-exchange grants	5,440	4,128	7,806
Investment income (loss)	(2,164)	4,837	37,144
Interest expense	(19,496)	(17,099)	(18,541)
Gain (loss) on disposal of capital assets	(7,364)	497	310
Other	(1,678)	721	1,752
Transfers (to) the University of Kentucky for noncapital purposes	(14,446)	(3,142)	(11,128)
Transfers (to) the University of Kentucky for capital purposes	(2,418)	1,810	1,890
Total other revenues (expenses)	(16,864)	(1,332)	(9,238)
Total increase in net position	84,015	192,033	121,721
Net position, beginning of year	1,013,750	821,717	699,996
Net position, end of year	$ 1,097,765	$ 1,013,750	$ 821,717

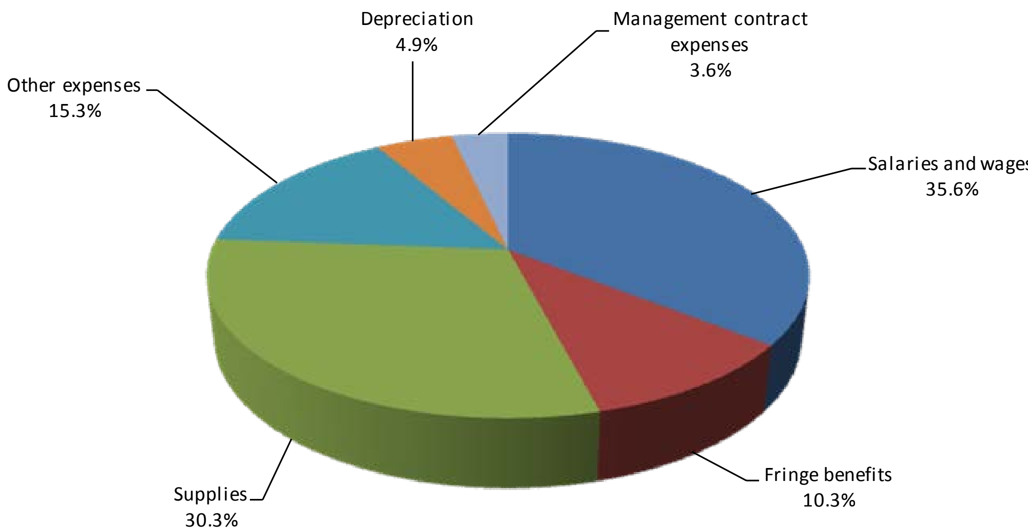
Operating Revenues:

Total operating revenues were approximately $1.42 billion for the year ended June 30, 2016, an increase of $94.6 million or 7.1% over fiscal year 2015. The most significant source of operating revenue for the System was net patient service revenues of $1.33 billion, an increase of $94.3 million or 7.6% in fiscal year 2016 over 2015.

Inpatient net revenue, including bad debt, increased $43.2 million or 5.6% over prior year. Rate was the primary driver of the increase which can be partially attributed to a 3.8% increase in acuity, with case mix index closing the year at 2.0005. In addition, a favorable payer mix change driven by an increase of 470 Medicaid cases, 136 commercial cases, and 109 Medicare cases.

Outpatient net revenue, including bad debt, increased by $51.1 million or 10.8% over prior year. Outpatient activity increased by 5.0% over prior year, including an increase of 7,022 in emergency room visits.

Bad debt provision decreased by $988,000 or 1.3% over prior year. The decrease was primarily associated with a continued decline in the uninsured self-pay patient population due to Medicaid expansion which took effect in January 2014.



Operating Expenses:

Total operating expenses, including $53.6 million of depreciation, were $1.30 billion, an increase of $168.7 million or 14.9% over the prior year.

Salaries and wages increased by $42.0 million over the prior fiscal year. The increase in salary and wages was driven by an FTE increase of 648, a 10.0% increase over prior year. This was compounded by an increase in rate per FTE as a result of various market adjustments for specific clinical personnel groups such as pharmacists, laboratory medical techs, occupational and physical therapists, and radiology techs. Fringe benefits increased $13.2 million or 13.5%. Management contract expenses related to Eastern State Hospital were $39.3 million, an increase of $3.4 million.

Supplies expenses increased by $40.6 million or 14.1% primarily due to increases in overall patient activity. Purchased services increased by $31.8 million or 17.4% due to increased commercial services or $17.2 million, $14.5 million in contract labor, and transfers to the College of Medicine of $7.7 million offset by decreased spending in outsourced services and professional contract services. Other expenses increased $37.3 million or 28.9% primarily as a result of increases in equipment service contracts computer maintenance, licenses and software, minor equipment purchases, building maintenance and renovation, professional liability claims, transplant services and post-acute care. Depreciation expense increased $436,000 or 0.8%.

Nonoperating Revenues (Expenses):

Total nonoperating expenses were ($24.2) million in fiscal year 2016 compared to nonoperating expenses of ($5.9) million during the prior fiscal year. This decrease is primarily due to interest expense of $19.5 million, a loss on disposal of capital net assets of $7.4 million, a net investment loss of $2.2 million, and to $1.7 million in other expenses. These decreases were offset by $5.4 million in gifts and non-exchange grants, and $1.1 million in State appropriations. The endowment pool posted a total loss of 1.8% for fiscal 2016 versus a total gain of 1.6% in the prior year.

2015 Versus 2014. Total operating revenues were $1.33 billion for the fiscal year ended June 30, 2015, an increase of $214.1 million over the year ended June 30, 2014. The increase in operating revenues was primarily due to increased net patient service revenues.

Operating expenses totaled $1.13 billion, an increase of $116.3 million over 2014. The increase was caused primarily by higher costs for personnel, supplies and depreciation.

Nonoperating expenses amounted to ($5.9) million in fiscal year 2015 compared to net nonoperating revenues, net of expenses, of $29.5 million in the prior year. This decrease is primarily due to a net investment gain of $4.8 million in fiscal year 2015 compared to a net investment gain of $37.1 million in the prior year.

Statement of Cash Flows

The Statement of Cash Flows details how cash has increased or decreased during the year ended June 30, 2016, with comparative financial information for the year ended June 30, 2015. It classifies the sources and uses of cash into the following categories:

- Operating activities
- Noncapital financing activities
- Capital and related financing activities
- Investing activities

Cash flows associated with the System's expendable net position appear in the operating and noncapital financing categories. Capital financing activities include payments for capital assets, proceeds from long-term debt and debt repayments. Purchases and sales of investments are reflected in investing activities.

The primary purpose of the Statement of Cash Flows is to provide information about the cash receipts and cash payments made by the System during the year that will allow financial statement readers to assess the System's:

- Ability to generate future net cash flows
- Ability to meet obligations as they become due
- Possible need for external financing

Condensed Statements of Cash Flows (in thousands)

	2016	2015	2014
CASH PROVIDED (USED) BY:			
Operating activities	$ 184,810	$ 263,731	$ 161,210
Noncapital financing activities	(6,459)	14,979	(2,264)
Capital and related financing activities	(165,993)	38,487	(102,791)
Investing activities	876	2,774	367
Net increase (decrease) in cash and cash equivalents	13,234	319,971	56,522
Cash and cash equivalents, beginning of year	431,639	111,668	55,146
Cash and cash equivalents, end of year	$ 444,873	$ 431,639	$ 111,668

2016. The major sources of cash included in operating activities was patient service revenues of $1.34 billion, sales and services of $48.3 million and management contract services of $39.7 million. Cash payments for operating activities were $707.2 million to suppliers, $491.0 million to employees for salaries, wages and fringe benefits, payments on management contract services of $39.3 million and other payments of $1.5 million.

Cash used by noncapital financing consists of transfers to the University of Kentucky for noncapital purposes of $14.4 million offset by an inflow of cash from gifts of $6.4 million, state appropriations of $1.1 million, and payments on loan from University departmental units of $534,000.

Cash used by capital and related financing activities included purchases of capital assets of $117.3 million, principal and interest payments on long-term obligations of $46.6 million, and transfers to the University of Kentucky for capital purposes of $2.1 million.

Investing activities included proceeds from sales and maturities of investments of $111.0 million and interest and dividends of $5.4 million. Cash of $115.6 million was used to purchase investments.

2015 Versus 2014. Cash balances increased when comparing fiscal year 2015 versus fiscal year 2014 with a net increase in cash of approximately $320.0 million, primarily from the significant increase in net income from continuing operations.

Key Ratios

The following table shows key liquidity and capital ratios for fiscal years 2016, 2015, and 2014:

	2016	2015	2014
Days cash on hand	131	146	42
Days of revenue in accounts receivable	39	41	43
Debt service coverage (times)	3.2	5.4	3.6

Days cash on hand decreased to 131 days in fiscal year 2016 from 146 days in fiscal year 2015 due to the increase in daily expenses of $451,000 per day. Days cash on hand measures the average number of days' expenses the System maintains in cash. In addition, the System has access to working capital from the University and quasi-endowment investments of $268.7 million.

The days of revenue in accounts receivable measures the average number of days it takes to collect accounts receivable. In fiscal year 2016, days in accounts receivable were 39 compared to 41 days in fiscal year 2015.

Debt service coverage ratio measures the amount of funds available to cover the principal and interest on long-term debt. The System's ratio for fiscal year 2016 is 3.2 versus 5.4 in fiscal year 2015 due to the smaller increase in net position in fiscal year 2016 compared to fiscal year 2015.

Capital Asset and Debt Administration

Capital Assets. Capital assets, net of accumulated depreciation, totaled approximately $878.4 million at June 30, 2016, a net increase of $51.6 million over the prior year end. Significant changes in capital assets during fiscal 2015-16 included (in millions):

Land, buildings and structures, net additions	$ 74.0
Equipment and vehicles, net additions	2.1
Capitalized software additions	6.6
Artwork	0.4
Construction in process, net additions	(4.8)
Increase in accumulated depreciation, net	(26.7)
Total	$ 51.6

Debt. At June 30, 2016, the System had $423.3 million in general receipts project notes outstanding and a $22.6 million loan due to the University; $14.9 million is included in current liabilities with the remainder long term. In addition, the System had $44.8 million in capital leases.

Economic Factors Impacting Future Periods

The following are known facts and circumstances that will affect future financial results:

- Health care reform has initiated significant change within the United States healthcare system, including material changes to the delivery of healthcare services and the reimbursement paid for such services. In June, 2016 Governor Matt Bevin announced sweeping changes to the state's $10 billion per year Medicaid program, saying he will seek permission from the Federal government to reshape the Federal-state health program that covers about 1.3 million Kentuckians. The plan is aimed to empower individuals to improve their health and well-being while simultaneously ensuring Medicaid's long-term fiscal sustainability. The long-term impact is largely unknown as the long period between passage and its implementation lends to some level of uncertainty. UK HealthCare continues to develop and execute strategies in an effort to leverage available opportunities and mitigate negative impacts of this legislation as details of the implementation unfold.
- The Federal Health Information Technology for Economic and Clinical Health (HITECH) Act and Patient Protection and Affordable Care (PPAC) Act, enacted in 2009 and 2010 respectively, included an initiative for every American to realize the benefits of an "Electronic Health Record" (EHR) by 2014. The PPAC Act included financial incentives for eligible hospitals and physicians to demonstrate meaningful use of an EHR. The Act also included penalties of up to three percent in reductions to Medicare reimbursement if an EHR is not established by 2015. For the last decade, UK Healthcare has utilized EHR and Computerized Physician Order Entry (CPOE) systems for inpatient care. However, in efforts to fully comply with the legislative requirements, maximize eligible financial incentives, and avoid reimbursement penalties, the system implemented the Allscripts EHR solution, Touchworks, for outpatient care across the enterprise.
- The US Department of Health and Human Services (DHHS) proposed the replacement of existing ICD-9-CM code sets used by medical coders and billers to report health care diagnoses and procedures with ICD-10 codes effective October 1, 2014. The original implementation deadline was extended to October 1, 2015 and is anticipated to radically change the way medical coding is performed. As a result, ICD-10 will require a significant internal effort to implement and train. UK HealthCare has allocated funding and initiated an organized effort around this project to meet DHHS requirements and the proposed deadline.
- In May and June 2016 UK HealthCare opened both the 9th and 10th floor of Pavilion A. The new state-of-the art areas will house medicine intensive care unit beds and universal beds for the medicine

service line. This investment will create incremental bed capacity for continued future clinical growth and quality outcomes.

- In 2016 UK HealthCare achieved Magnet Status – the highest institutional honor awarded for nursing excellence from the American Nurses Credentialing Center's Magnet Recognition Program. Out of nearly 6,000 health care organizations in the United States, less than seven percent have achieved Magnet designation. Achieving Magnet Status is a process that culminates in a rigorous review to demonstrate the hospital's commitment to sustaining nursing excellence and improving professional practice. The status represents a solid commitment to continuing education and nursing specialty certification, a cultural transformation of the work environment involving a shared governance model and laser focus on patient safety.

UK HEALTHCARE HOSPITAL SYSTEM
AN ORGANIZATIONAL UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF NET POSITION (in thousands)
JUNE 30, 2016 AND 2015

	2016	2015
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES		
Current Assets		
Cash and cash equivalents	$ 338,804	$ 272,314
Accounts receivable (less allowance for doubtful accounts of $63,419 in 2016 and $43,014 in 2015)	140,270	137,848
Inventories and other assets	34,079	32,431
Notes receivable	2,800	2,667
Total current assets	515,953	445,260
Noncurrent Assets		
Restricted cash and cash equivalents	106,069	159,325
Long-term investments	268,666	271,708
Capital assets, net	878,391	826,805
Notes receivable	3,939	4,425
Other assets	2,155	3,100
Total noncurrent assets	1,259,220	1,265,363
Total assets	1,775,173	1,710,623
Deferred Outflows of Resources	10,946	12,368
Total assets and deferred outflows of resources	1,786,119	1,722,991
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	134,953	122,648
Unearned revenue	7,030	10,622
Estimated third-party payer settlements	22,818	20,158
Long-term debt - current portion	14,960	15,020
Capital lease obligations - current portion	10,733	12,170
Total current liabilities	190,494	180,618
Noncurrent Liabilities		
Long-term liabilities - other	32,911	38,009
Long-term liabilities - debt	430,925	445,885
Capital lease obligations	34,024	44,729
Total noncurrent liabilities	497,860	528,623
Total liabilities	688,354	709,241
NET POSITION		
Net investment in capital assets	455,374	437,489
Restricted		
Nonexpendable other	195	119
Expendable		
Capital projects	5,212	3,154
Other	6,690	7,384
Total restricted expendable	11,902	10,538
Total restricted	12,097	10,657
Unrestricted	630,294	565,604
Total net position	$ 1,097,765	$ 1,013,750

See notes to financial statements.

UK HEALTHCARE HOSPITAL SYSTEM
AN ORGANIZATIONAL UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION (in thousands)
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

	2016	2015
OPERATING REVENUES		
Net patient service revenues, less provision for doubtful accounts of $74,858 in 2016 and $75,846 in 2015	$ 1,332,714	$ 1,238,392
Sales and services	48,307	51,476
Management contract revenue	42,674	39,265
Total operating revenues	1,423,695	1,329,133
OPERATING EXPENSES		
Salaries and wages	385,834	343,872
Fringe benefits	111,343	98,101
Supplies	327,766	287,184
Purchased services	214,458	182,656
Other expenses	166,267	129,015
Depreciation	53,603	53,167
Management contract expenses	39,336	35,910
Total operating expenses	1,298,607	1,129,905
Net income from continuing operations	125,088	199,228
NONOPERATING REVENUES (EXPENSES)		
State appropriations	1,053	1,053
Gifts and non-exchange grants	5,440	4,128
Investment income (loss)	(2,164)	4,837
Interest expense	(19,496)	(17,099)
Gain (loss) on disposal of capital assets	(7,364)	497
Other	(1,678)	721
Net nonoperating revenues (expenses)	(24,209)	(5,863)
Net income before other revenues, expenses, gains or losses	100,879	193,365
Transfers (to) the University of Kentucky for noncapital purposes	(14,446)	(3,142)
Transfers (to) from the University of Kentucky for capital purposes	(2,418)	1,810
Total other revenues (expenses)	(16,864)	(1,332)
INCREASE IN NET POSITION	84,015	192,033
NET POSITION, beginning of year	1,013,750	821,717
NET POSITION, end of year	$ 1,097,765	$ 1,013,750

See notes to financial statements.

UK HEALTHCARE HOSPITAL SYSTEM
AN ORGANIZATIONAL UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF CASH FLOWS (in thousands)
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net patient service revenues	$ 1,335,901	$ 1,248,616
Sales and services	48,307	51,476
Management contract services	39,737	44,371
Payments to vendors and contractors	(707,224)	(606,885)
Salaries, wages and fringe benefits	(491,036)	(436,241)
Payments on management contract services	(39,336)	(38,635)
Other receipts (payments)	(1,539)	1,029
Net cash provided (used) by operating activities	184,810	263,731
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	1,053	1,053
Gifts	6,399	5,457
Payments on loans from University of Kentucky departmental units	534	12,757
Transfers from (to) the University of Kentucky for noncapital purposes	(14,446)	(4,288)
Net cash provided (used) by noncapital financing activities	(6,459)	14,979
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of capital assets	-	4,361
Purchases of capital assets	(117,284)	(66,910)
Payments to refunding bond agents	-	(196,331)
Principal payments-capital leases and long-term obligations	(27,162)	(32,611)
Interest payments-capital leases and long-term obligations	(19,478)	(16,764)
Proceeds from long-term obligations	-	346,331
Other capital and related financing payments	-	(244)
Transfers from (to) the University of Kentucky for capital purposes	(2,069)	655
Net cash provided (used) by capital and related financing activities	(165,993)	38,487
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	111,008	81,416
Purchase of investments	(115,565)	(80,918)
Interest and dividends on investments	5,433	2,276
Net cash provided (used) by investing activities	876	2,774
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	13,234	319,971
CASH AND CASH EQUIVALENTS, beginning of year	431,639	111,668
CASH AND CASH EQUIVALENTS, end of year	$ 444,873	$ 431,639
Reconciliation of net income from continuing operations to net cash provided by operating activities:		
Net income from continuing operations	$ 125,088	$ 199,228
Adjustments to reconcile net income from continuing operations to net cash provided (used) by operating activities:		
Depreciation	53,603	53,167
Write off of principal note/lease receivable	(633)	778
Provision for doubtful accounts	(74,858)	(75,846)
Change in assets and liabilities:		
Accounts receivable	72,436	60,184
Inventories and other	(1,648)	(6,663)
Estimated third-party payer settlements receivable and payable	2,661	26,648
Other assets	434	(541)
Accounts payable and accrued liabilities	11,319	3,699
Unearned revenue	(3,592)	3,077
Net cash provided by operating activities	$ 184,810	$ 263,731
NON CASH TRANSACTIONS:		
Transfer of capital assets from (to) UK	$ (349)	$ 1,155
Capital lease additions (reductions)	$ -	$ 1,365
Capital asset additions in accounts payable	$ 6,229	$ 6,240
Capitalized interest, net of investment income	$ 2,032	$ 865
Amortized bond premium	$ 4,116	$ 5,543

See notes to financial statements.

UK HEALTHCARE HOSPITAL SYSTEM
AN ORGANIZATIONAL UNIT OF THE UNIVERSITY OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The UK HealthCare Hospital System (the System) is an organizational unit of the University of Kentucky (the University) which is a component unit of the Commonwealth of Kentucky (the Commonwealth) and is included in the basic financial statements of the Commonwealth. The financial statements of UK HealthCare Hospital System include Albert B. Chandler University Hospital including Kentucky Children's Hospital (collectively Chandler); UK HealthCare Good Samaritan Hospital (Good Samaritan); and Kentucky Healthcare Enterprise, Inc. (KHE), a wholly owned for-profit subsidiary.

The System provides inpatient, outpatient and emergency care services for residents of the Commonwealth.

Basis of Presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). GASB establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net position categories:

- Net investment in capital assets: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

- Restricted:
  Nonexpendable – Net position subject to externally imposed stipulations that it be maintained permanently by the System.

  Expendable – Net position whose use by the System is subject to externally imposed stipulations that can be fulfilled by actions of the System pursuant to those stipulations or that expire by the passage of time.

- Unrestricted: Net position whose use by the System is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Trustees or may otherwise be limited by contractual agreements with outside parties.

The financial statement presentation is intended to provide a comprehensive, entity-wide perspective of the System's assets, deferred outflows of resources, liabilities, net position, revenues, expenses, changes in net position and cash flows.

Summary of Significant Accounting Policies

Accrual Basis. The financial statements have been prepared on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when an obligation has been incurred. The System reports as a Business Type Activity (BTA) as defined by GASB Statement No. 35. BTA's are those activities that are financed in whole or part by fees charged to external parties for goods and services.

Cash and Cash Equivalents. The System considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Noncurrent cash and cash equivalents include the System's plant funds allocated for capital projects, with the exception of unrestricted renewal and replacement cash, which is included in current cash and cash equivalents, and endowment fund cash pending transfer to the custodian for investment. Cash and cash equivalents held by the University's endowment fund managers are included in long-term investments.

Accounts Receivable. The System reports patient accounts receivable for services rendered at net realizable amounts from third-party payers and others. The System provides an allowance for doubtful accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Inventories. Inventories are stated principally at the lower of average cost or market.

Long-Term Investments. The System's endowment investments are administered as part of the University's pooled endowment funds. All endowments are managed in a consolidated investment pool which consists of more than 2,100 named funds. All contributing endowments participate in the income and appreciation of the pool on a per unit basis commensurate with their contribution to the pool. New endowments purchase units in the pool at the current value, which is calculated each month based on the fair value of the pool investments divided by the number of pool units outstanding. The market value method of accounting for pooled endowment funds is employed to ensure proper distribution of market price changes, realized gains (losses) on sales, accrued income earned, and distribution of investment earnings for expenditure by participating funds.

Pooled Endowment Funds. In accordance with the Kentucky Uniform Prudent Management of Institutional Funds Act (UPMIFA), as adopted by the Commonwealth in July 2010, the University employs a total return method for establishing investment objectives and spending policies designed to achieve financial equilibrium for endowment funds over the long term. The University makes expenditure decisions in accordance with UPMIFA and donor gift agreements. UPMIFA prescribes guidelines for expenditure of a donor-restricted endowment fund (in the absence of overriding, explicit donor stipulations) and focuses on the entirety of a donor-restricted endowment fund, that is, both the original gift amount(s) and net appreciation. In accordance with the standard of prudence prescribed by UPMIFA and consistent with industry standards, the University has adopted a spending policy whose long-term objective is to maintain the purchasing power of each endowment and provide a predictable and sustainable level of income to support current operations.

The adopted spending policy is a "hybrid" spending policy, which includes both the market value of the endowment and the current level of inflation in determining spending each year. Annual spending will be calculated by taking a weighted average comprising 60% of the prior year's spending, adjusted for inflation, and 40% of the amount that results when the target annual spending rate of four percent is applied to the average market value of the endowment over the preceding 36 months. The spending amount determined by the formula will be constrained so that the calculated rate is at least three percent, and not more than six percent, of the current endowment market value.

The University also utilized an endowment management fee to support internal management and fundraising costs related to the endowment. For the years ended June 30, 2016 and 2015 the University's annual endowment management fee was 0.50% and 0.25% respectively.

To protect endowment funds from permanent impairment of value, spending and management fee withdrawals are suspended on endowments with a market value less than the contributed value by more than 20%. Additionally, endowments with a market value less than the contributed value by more than 10% undergo a formal review to determine the appropriate level of spending in accordance with various factors set forth in UPMIFA. All donor restrictions and stipulations prevail in decisions regarding preservation and spending of endowment funds.

For each of the years ended June 30, 2016 and 2015, management elected to retain the spending distribution in the quasi endowment and the amounts available for spending in accordance with the University's endowment spending policy was $9.1 million and $8.6 million, respectively.

Capital Assets. Capital assets are stated at cost at date of acquisition or, in the case of gifts, at fair market value at date of gift.

The System capitalizes interest costs as a component of construction in progress, based on the interest cost of borrowing specifically for a currently active project, net of interest earned on investments acquired with the proceeds of the borrowing. The System also capitalizes interest costs as a component of construction in progress on projects funded by unrestricted funds based on the interest costs of borrowings no longer associated with a specific project. The calculation is based on a project's average expenditures times the weighted average interest rate borrowings.

Equipment with a unit cost of $5,000 and having an estimated useful life of greater than one year is capitalized. Institutional software costing more than $400,000 is capitalized. Renovations to buildings, infrastructure and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred.

Depreciation of capital assets is computed on a straight-line basis over the estimated useful lives of the respective assets, generally 40 years for buildings, 10 – 25 years for land and building improvements and infrastructure, 5 – 20 years for equipment and vehicles and 10 years for capitalized software.

Title to all capital assets of the System belongs to the University. The financial information relating to capital assets represents assets that the System occupies and uses. Transfer of capital assets to/from the University represents changes in control of individual assets within divisions of the University from one period to another.

Deferred Outflows of Resources. A deferred outflow of resources is a loss in net position by the System that is applicable to a future reporting period. Deferred outflows of resources are reported in the statement of net position, but are not recognized in the financial statements as expense until in the related period. Deferred outflows of resources of $10.9 million as of June 30, 2016 and $12.4 million as of June 30, 2015, consisted of the unamortized difference between the reacquisition price and the net carrying amount of the refunded debt. The System issued General Receipts 2014 Bonds Series D to refund General Receipts 2005 Notes Series A which was originally issued to fund the construction of the Patient Care Facility. General Receipts Notes 2007 Series A and B originally issued to fund construction of the Patient Care Facility were refunded by the by the General Receipts 2015 Bond Series B.

Unearned Revenue. Unearned revenue consists of amounts received from the federal government through the Commonwealth for Disproportionate Share System (DSH) funds and other unearned amounts. The DSH amounts are recognized as revenue over the term of the federal government fiscal year, October 1 – September 30.

Compensated Absences. The amount of vacation leave earned but not taken by employees at June 30, 2016 is recorded as a liability by the System. Temporary disability leave payable upon termination under the University's payout policy is also recorded as a liability on the University's financial statements. Compensated absence liabilities are computed using the pay rates in effect at the statement of net position date plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

Net Patient Service Revenues. Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered, including contractual allowances and estimated retroactive adjustments under reimbursement programs with third-party payers and include a provision for doubtful accounts. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient skilled nursing services are paid at prospectively determined per diem rates that are based on the patients' acuity. Certain inpatient nonacute services and defined medical education costs are paid based on a cost reimbursement methodology. The System is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare fiscal intermediary.

Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology for certain services and at prospectively determined rates for all other services. The System is reimbursed for cost reimbursable services at tentative rates with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicaid fiscal intermediary.

Revenue from the Medicare and Medicaid programs accounted for approximately 24% and 31%, respectively, of the System's net patient service revenues before the provision for doubtful accounts for the year ended June 30, 2016 and approximately 28% and 27%, respectively for the year ended June 30, 2015. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. With expanded Medicaid, more Kentuckians are becoming insured, resulting in a decrease in the System's self-pay population. This has led to the System's inability to qualify for Disproportionate Share Hospital payments from Medicaid. The monies received from Medicaid which will be recouped are represented as a future liability on the balance sheet as third-party settlements.

The System also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the System under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Management Contract Revenue. The System entered into a contract with the Kentucky Cabinet for Health and Family Services (CHFS) to manage Eastern State Hospital (ESH) and Central Kentucky Recovery Center (CKRC). Under the contract the System is reimbursed 100% of the related operating expenses up to a limit of $40.1 million, and $1.9 million, for ESH and CKRC respectively. The System also receives an eight percent management fee. The initial contract term was August 13, 2013 to June 30, 2014 with the option to renew the contract for two additional one-year terms. Subsequent to year end, the contract was renewed for the period of July 1, 2016 to June 30, 2017 with substantially the same terms.

Electronic Health Records Incentive Program. The Electronic Health Records Incentive Program, enacted as part of *the American Recovery and Reinvestment Act of 2009*, provides for incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records technology. Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under both programs is contingent on the System continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The System recognizes revenue when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

In fiscal year 2016, the System was in the fifth year under the Medicare program and recorded $550,000, which is included in net patient service revenue within operating revenues in the statement of revenues, expenses, and changes in net position. In fiscal year 2015, the System was in the fourth year of the Medicare program and recorded $1.1 million. The System received no revenue under the Medicaid program as final payment was received in 2014.

Charity Care. The System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Since the System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Income Taxes. The University, of which the System is an organizational unit, is an agency and instrumentality of the Commonwealth, pursuant to Kentucky Revised Statutes sections 164.100 through 164.280. Accordingly, the University is excluded from federal Income taxes as an organization described in Section 115 of the Internal Revenue Code of 1986, as amended.

Restricted Asset Spending Policy. The System's policy is that restrictions on assets cannot be fulfilled by the expenditure of unrestricted funds for similar purposes. The determination of whether restricted or unrestricted funds are expended for a particular purpose is made on a case-by-case basis. Restricted funds remain restricted until spent for the intended purpose.

Operating Activities. The System defines operating activities, as reported on the Statement of Revenues, Expenses and Changes in Net Position, as those that generally result from exchange transactions, such as payments received for providing goods and services and payments made for goods and services received. Nearly all of the System's revenues and expenses are from exchange transactions. Certain revenues relied upon for operations, such as state appropriations, gifts and investment income, are recorded as non-operating revenues, in accordance with GASB Statement No. 35.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The accompanying financial statements include estimates for items such as contractual allowances, allowances for doubtful accounts, estimated third-party payer settlements and estimated medical claims payable.

Recent Accounting Pronouncements. As of June 30, 2016, the GASB has issued the following applicable statements to the University but are not yet implemented.

- GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements No. 67 and 68,* issued June 2015. The pension provisions of this Statement are effective for fiscal years beginning after June 15, 2016, (fiscal year 2017). This statement establishes requirements for defined contribution pensions plans not administered through trusts that meet certain criteria. The University has certain employees who were age 40 or older prior to the establishment of each group retirement plan that qualify for minimum annual retirement benefits. (see note 16) The University is currently evaluating the effect statement No. 73 will have on its financial statements. As an organization unit of the University, the System has no additional liability for this potential liability.
- GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, issued June 2015. The provisions of this Statement are effective for fiscal years beginning after June 15, 2017, (fiscal year 2018). This statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expenses. This statement addresses employers whose employees are provided defined contribution other postemployment benefits. The University is working with an actuary to determine the impact of the pronouncement. Although specific amounts are not yet known, this is expected to result in a significant liability for the unfunded portion being recorded on the University's financial statements. As an organizational unit of the University, the System has recognized its share of the contribution in employee benefit costs and has no additional liability for this unfunded portion.
- GASB Statement No. 81, Irrevocable Split-Interest Agreements, issued March 2016. The provisions of this Statement are effective for fiscal years beginning after December 15, 2016, (fiscal year 2018). This statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognizes assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period. The System is currently assessing the impact statement No. 80 will have on its financial statements

2. DEPOSITS AND INVESTMENTS

The fair value of deposit and investment, by statement of net position classification, at June 30, 2016 and 2015 are as follows (in thousands):

	2016	2015
Statement of Net Position classification:		
Cash and cash equivalents	$ 338,804	$ 272,314
Restricted cash and cash equivalents	106,069	159,325
Long-term investments	268,666	271,708
	$ 713,539	$ 703,347

Fair Value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at a measurement date. The framework for measuring fair value established by generally accepted accounting principles provides a fair value hierarchy as follows:

Level 1	Quoted prices in active markets for identical assets or liabilities
Level 2	Observable inputs other than level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
Level 3	Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities

The University categorizes its fair value measurements within the fair value hierarchy. Certain investments are measured at fair value using net asset value per share (or its equivalent), practical expedient, amortized costs, or historical costs and therefore have not been classified in the fair value hierarchy. These investments have been included in the table below to permit reconciliation of the fair value hierarchy to the amounts presented in the Statement of Net Position.

The fair value of deposits and investments, by type, at June 30, 2016 and 2015 follows (in thousands):

	2016				
		Fair Value Measurement Using			
	Total Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Unobservable Inputs (Level 3)	Total Measured at Fair Value	Amortized or Historical Cost
Cash and cash equivalents	$ 444,873	$ -	$ -	$ -	$ 444,873
Guaranteed investment contracts	34	-	-	-	34
Cash surrender value of life insurance policies	550	-	-	-	550
Pooled equity funds	162	162	-	162	-
Pooled real estate funds	15	15	-	15	-
Endowed deposits and investments	267,905	-	267,905	267,905	-
Total deposits and investments	$ 713,539	$ 177	$ 267,905	$ 268,082	$ 445,457

	2015				
		Fair Value Measurement Using			
	Total Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Unobservable Inputs (Level 3)	Total Measured at Fair Value	Amortized or Historical Cost
Cash and cash equivalents	$ 431,639	$ -	$ -	$ -	$ 431,639
Guaranteed investment contracts	159	-	-	-	159
Pooled equity funds	844	844	-	844	-
Pooled real estate funds	78	78			
Endowed deposits and investments	270,627	-	270,627		-
Total deposits and investments	$ 703,347	$ 922	$ 270,627	$ 844	$ 431,798

Where quoted market prices are available in an active market, securities are classified within level 1 of the valuation hierarchy. If quoted prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatiles, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in level 2 of the valuation hierarchy.

The investment in University pooled endowment fund is derived based on the per unit calculation as described in footnote 1, thus is deemed to be a level 3 investment. There have been no significant changes in the valuation techniques during the year ended June 30, 2016. For more information regarding the fair value measurements, refer to the University's financial statements, footnote 2.

The composition of the University's pooled endowment fund based upon fair value at June 30, 2016 and 2015 is as follows:

	2016	2015
Cash and cash equivalents	0.7%	0.4%
Common and preferred stock	3.1%	3.5%
Corporate fixed income securities	0.5%	0.7%
Government agency fixed income securities	0.2%	0.2%
Pooled absolute return funds	11.5%	10.0%
Pooled diversified inflation strategies funds	7.5%	-
Pooled equity funds	24.3%	26.2%
Pooled fixed income funds	5.9%	7.3%
Pooled global tactical asset allocation funds	6.8%	7.2%
Pooled long/short equity funds	13.6%	14.2%
Pooled private equity funds	14.4%	12.8%
Pooled real estate funds	10.6%	8.5%
Pooled real return funds	-	8.3%
U.S. Treasury fixed income securities	0.9%	0.7%
Total	100.0%	100.0%

Deposit and Investment Policies. The University's Board of Trustees is responsible for establishing deposit and investment policies for the System. Once established, the Board has delegated day-to-day management to the Treasurer of the University. Deposit and investment policies are developed to insure compliance with state laws and regulations, as well as to establish and maintain sound financial management practices.

For purposes of investment management, the System's deposits and investments can be grouped into two significant categories:

- Cash on deposit with the University, which the University invests in deposits and money market funds with banks, the Commonwealth and other financial institutions. During the fiscal year ended June 30, 2016, the University invested in repurchase agreements with banks and the Commonwealth.
- Endowment investments in the University's pooled endowment fund.

Cash on deposit with the University is managed by the University following the University's Operating Fund Investment Policy established by the Treasurer of the University.

Endowment investments are managed by the University's Endowment Investment Policy established by the Investment Committee of the University's Board of Trustees, which governs the University's pooled endowment fund.

Deposit and Investment Risks. The System's deposits and investments are exposed to various risks including credit, interest rate and foreign currency risk. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could affect the investment amounts in the Statements of Net Position.

Credit Risk. Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligation, causing the System to experience a loss of principal.

As a means of limiting its exposure to losses arising from credit risk, the University's investment policies limit the exposure of its various investment types, as follows:

- Cash on deposit with the University is governed by policy that minimizes risk in several ways. Deposits are governed by state law which requires full collateralization for balances exceeding amounts covered by the Federal Deposit Insurance Corporation (FDIC). The System's deposits are insured up to $250,000 at each FDIC insured institution. Credit risk on deposits in excess of FDIC coverage and on repurchase agreements with local banks is mitigated by the issuing financial institution's pledge of specific U.S. Treasury or agency securities, held in the name of the University by the Federal Reserve Bank. Credit risk on repurchase agreements with the Commonwealth is mitigated by the Commonwealth's requirement that providers of overnight repurchase agreements collateralize these investments at 102% of face value with U.S. Treasury or agency securities, pledged in the name of the Commonwealth. Money market fund portfolios consist of securities eligible for short-term investments.
- Endowment managers are permitted to use derivative instruments to limit credit risk.

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investment or collateral securities that are in possession of an outside party.

As a means of limiting its exposure to losses arising from custodial credit risk, the University's investment policies limit the exposure of its various investment types, as follows:

- Cash on deposit with the University is invested in deposits, money market funds and repurchase agreements. These investments are not exposed to custodial credit risk other than repurchase agreements with the Commonwealth, which are held in the Commonwealth's name. Deposits and money market investments are held in the University's name by various financial institutions. The University maintains records evidencing the System's ownership interest of such balances.
- Endowment investments are held in the University's name by the University's custodian. The University maintains records evidencing the System's ownership interest of such balances.

Concentrations of Credit Risk. The System's investments can be exposed to a concentration of credit risk if significant amounts are invested in any one issuer.

As a means of limiting its exposure to concentrations of credit risk, the University's investment policies limit concentrations in various investment types, as follows:

- Cash on deposit with the University is not limited as to the maximum amount that may be deposited or invested in one issuer. However, all such deposits in excess of federal deposit insurance are required to be fully collateralized by U.S. Treasury and/or U.S. agency securities or other similar investments as provided by KRS 41.240.
- The University's endowment fixed income managers are limited to a maximum investment in any one issuer of no more than five percent of total investments excluding sovereign debt of governments belonging to the Organization for Economic Cooperation and Development and U.S. agencies.

At June 30, 2016 and 2015, the System had no investments in any one issuer that represented five percent or more of total investments, other than U.S. Treasury and agency obligations.

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

As a means of limiting its exposure to fair value losses arising from increasing interest rates, the University's investment policies limit the maturity of its various investment types, as follows:

- Cash on deposit with the Commonwealth has limited exposure to interest rate risk due to the short-term nature of the investment. The University requires that all deposits and repurchase agreements be available for use on the next business day.
- Endowment managers are permitted to use derivative instruments to limit interest rate risk. Additionally, endowment investments held by the University's core-plus fixed income managers are limited to a duration that is within two years of the duration of the Barclay's Aggregate Bond Index and new unconstrained fixed income strategies have been implemented to further protect against interest rate risk.

Foreign Currency Risk. Foreign currency risk is the risk that fluctuations in exchange rates will adversely affect the fair value of an investment or deposit.
The System's exposure to foreign currency risk derives from certain endowment investments of the University's pooled endowment fund. The University's investment policy allows fixed income managers to invest a portion of their portfolios in non-U.S. securities. Additionally, the investment policy allows various pooled fund managers to invest in accordance with the guidelines established in each individual fund's prospectus, which allows for investment in non-U.S. securities. Endowment managers are permitted to use derivative instruments to limit foreign currency risk. .

3. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net, as of June 30, 2016 and 2015 are as follows (in thousands):

	2016		
	Gross Receivable	Allowance	Net Receivable
Medicare, Medicaid and other third parties	$ 533,110	$ (396,081)	$ 137,029
Private pay	9,338	(7,250)	2,088
Pledges receivable (less discount of $0)	3,389	(2,236)	1,153
Total	$ 545,837	$ (405,567)	$ 140,270

	2015		
	Gross Receivable	Allowance	Net Receivable
Medicare, Medicaid and other third parties	$ 489,828	$ (357,376)	$ 132,452
Private pay	10,477	(6,295)	4,182
Pledges receivable (less discount of $32)	3,305	(2,091)	1,214
Total	$ 503,610	$ (365,762)	$ 137,848

The above pledges receivable are shown net of present value discount.

In accordance with GASB Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions, the System is required to record operating and capital pledges as revenue when all eligibility requirements have been met. For the years ended June 30, 2016 and 2015, the System recorded the discounted value of operating and capital pledges using a rate of two percent.

The System has recorded an allowance for uncollectible patient accounts receivable equal to 30.6% and 25.5% of patient accounts receivable as of June 30, 2016 and 2015, respectively. A summary of the changes in the allowance for uncollectible patient accounts receivable is as follows:

	2016	2015
Balance, beginning of year	$ 43,014	$ 27,669
Provision for bad debts	74,858	75,846
Receivables charged off, net of recoveries	(54,453)	(60,501)
Balance, end of year	$ 63,419	$ 43,014

4. CAPITAL ASSETS, NET

Capital assets as of June 30, 2016 and capital asset activity for the year ended June 30, 2016 are summarized as follows (in thousands):

	Beginning Balance	Additions	Deletions	Ending Balance
Land	$ 25,338	$ 150	$ -	$ 25,488
Non-depreciable land improvements	15,607	590	-	16,197
Depreciable land improvements	8,737	-	-	8,737
Buildings	767,775	66,955	51	834,679
Fixed equipment	23,987	6,309	-	30,296
Infrastructure	27,866	-	-	27,866
Equipment	259,965	36,878	34,758	262,085
Vehicles	1,220	-	-	1,220
Capitalized software	79,565	6,617	-	86,182
Artwork	1,850	418	-	2,268
Construction in process	25,539	1,844	6,601	20,782
Certificate of need	11,609	-	-	11,609
	1,249,058	119,761	41,410	1,327,409
Accumulated Depreciation:				
Depreciable land improvements	4,896	351	-	5,247
Buildings	186,690	19,077	6	205,761
Fixed equipment	13,003	2,151	-	15,154
Infrastructure	6,094	1,115	-	7,209
Equipment	175,358	24,062	26,832	172,588
Vehicles	884	113	-	997
Capitalized software	35,328	6,734	-	42,062
	422,253	53,603	26,838	449,018
Capital assets, net	$ 826,805	$ 66,158	$ 14,572	$ 878,391

Capital assets as of June 30, 2015 and capital asset activity for the year ended June 30, 2015 are summarized as follows (in thousands):

	Beginning Balance	Additions	Deletions	Ending Balance
Land	$ 25,338	$ -	$ -	$ 25,338
Non-depreciable land improvements	15,607	-	-	15,607
Depreciable land improvements	8,737	-	-	8,737
Buildings	734,330	33,783	338	767,775
Fixed equipment	22,157	1,830	-	23,987
Infrastructure	27,865	1	-	27,866
Equipment	249,453	31,083	20,570	259,966
Vehicles	934	369	84	1,219
Capitalized software	74,080	5,486	-	79,566
Artwork	1,801	49	-	1,850
Construction in process	22,767	34,840	32,069	25,538
Certificate of need	11,609	-	-	11,609
	1,194,678	107,441	53,061	1,249,058
Accumulated Depreciation:				
Depreciable land improvements	4,542	354	-	4,896
Buildings	169,152	17,590	52	186,690
Fixed equipment	11,154	1,849	-	13,003
Infrastructure	4,979	1,115	-	6,094
Equipment	166,099	25,936	16,677	175,358
Vehicles	855	113	84	884
Capitalized software	29,118	6,210	-	35,328
	385,899	53,167	16,813	422,253
Capital assets, net	$ 808,779	$ 54,274	$ 36,248	$ 826,805

At June 30, 2016, the System has construction projects in progress totaling approximately $217.2 million in scope. The estimated cost to complete these projects was approximately $189.3 million. Such construction is principally financed by the System’s cash reserves, loans from the University and proceeds from the System general receipts bonds.

Interest costs incurred during construction, net of related investment income, are capitalized. Total interest capitalized was $2.0 million for 2016 and $865,000 for 2015.

During 2016 and 2015, the System utilized capital leases to acquire various items of equipment. The net book value for capitalized leased land, buildings and equipment is $45.0 million and $53.2 million at June 30, 2016 and 2015, respectively.

5. NOTES RECEIVABLE

Notes receivable at June 30, 2016 and 2015 are as follows (in thousands):

	2016	2015
Non-interest bearing, unsecured receivable from UK College of Pharmacy	$ 5,000	5,500
Non-interest bearing, unsecured receivable from UK College of Nursing	1,739	-
Notes receivable - other	-	1,592
Total	$ 6,739	$ 7,092
Current portion	$ 2,800	$ 2,667
Noncurrent portion	3,939	4,425
Total	$ 6,739	$ 7,092

6. OTHER ASSETS

Other assets at June 30, 2016 and 2015 are as follows (in thousands):

	2016	2015
Amounts on deposit with trustee	$ 25	$ 27
Noncurrent portion of prepaid expenses	287	271
Pledges receivable noncurrent, net	1,843	2,802
Total	$ 2,155	$ 3,100

The amounts on deposit with the trustee represent cash equivalents, measured as a level 1 on the fair value hierarchy as discussed in note 2.

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2016 and 2015 are summarized as follows (in thousands):

	2016	2015
Payable to vendors and contractors	$ 57,647	$ 54,726
Due to the University of Kentucky	3,617	3,680
Accrued expenses, including vacation leave	73,689	64,242
Total	$ 134,953	$ 122,648

8. LONG-TERM DEBT

Long-term debt as of June 30, 2016 and 2015 are summarized as follows (in thousands):

	2016					
	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion	Noncurrent Portion
General Receipts Project Notes	$ 435,245	$ -	$ 11,995	$ 423,250	$ 11,901	$ 411,349
Due to the University of Kentucky	25,660	-	3,025	22,635	3,059	19,576
Total	$ 460,905	$ -	$ 15,020	$ 445,885	$ 14,960	$ 430,925

	2015					
	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion	Noncurrent Portion
General Receipts Project Notes	$ 321,010	$ 306,293	$ 192,058	$ 435,245	$ 11,995	$ 423,250
Due to the University of Kentucky	29,828	-	4,168	25,660	3,025	22,635
Total	$ 350,838	$ 306,293	$ 196,226	$ 460,905	$ 15,020	$ 445,885

Principal maturities and interest on long-term debt for the next five years and in subsequent five-year periods as of June 30, 2016 are as follows (in thousands):

	Principal	Interest	Total
2017	14,960	20,031	34,991
2018	18,587	19,311	37,898
2019	19,039	18,513	37,552
2020	19,502	17,672	37,174
2021	22,616	16,776	39,392
2022-2026	118,500	67,520	186,020
2027-2031	78,970	41,988	120,958
2032-2036	56,855	28,681	85,536
2037-2041	61,690	14,456	76,146
2042-2045	35,166	3,584	38,750
Total	$ 445,885	$ 248,532	$ 694,417

Bond premiums, which are included in current and noncurrent accrued liabilities, are amortized over the life of the bond using the effective interest method.

The general receipts project notes consist of bonds in the original amount of $672.6 million dated November 8, 2007 through April 15, 2015, which bear interest at 2.24% to 4.66%. The bonds are payable in annual installments through June 30, 2045. The System is required to make semi-annual deposits of varying amounts to the debt service funds held by the trustees. The bonds are secured by pledged revenues of the University, which include the net revenues of the System.

On November 24, 2009, $100.6 million of the University of Kentucky General Receipts 2009 Bonds Series B were issued at a net interest cost of 3.59%. These bonds were issued as Build America Bonds (BAB) as authorized under the American Recovery and Reinvestment Act of 2009. The System will receive an annual cash subsidy from the U.S. Treasury equal to 35% of the interest payable on the bonds. This subsidy, which was approximately $1.8 million during fiscal year 2016, is included in gifts and non-exchange grants in the statements of revenues, expenses and changes in net position. The subsidy payment is contingent on federal regulations and may be subject to change. On March 1, 2013, the President signed an executive order to reduce the budgetary authority in accounts subject to sequestration, As a result, the BAB subsidy was reduced to approximately 32% in both 2016 and 2015.

On July 30, 2010, the System entered into an unsecured internal loan agreement with the University to acquire funding for construction of a suite of operating rooms in the newly constructed patient care facility. Funds will be transferred to the construction project as needed and will be repaid over a ten year period. Interest shall be charged based on the historical performance of the two-year U.S. Treasury note plus (1.0%). The total effective rate was 1.66% for interest payments in 2016 and 1.32% in 2015. The annual interest rate will be determined March 1 and be effective for the following fiscal year.

At June 30, 2016, assets with a fair market value of approximately $114.5 million have been placed on deposit with trustees to totally defease bonds with a par amount of $107.4 million. The liability for these fully defeased bonds is not included in the financial statements.

9. CAPITAL LEASE OBLIGATIONS

Capital lease obligations as of June 30, 2016 and 2015 are summarized as follows (in thousands):

2016					
Beginning Balance	Additions	Reductions	Ending Balance	Current Portion	Noncurrent Portion
$ 56,899	$ -	$ 12,142	$ 44,757	$ 10,733	$ 34,024

2015					
Beginning Balance	Additions	Reductions	Ending Balance	Current Portion	Noncurrent Portion
$ 72,434	$ 2,296	$ 17,831	$ 56,899	$ 12,170	$ 44,729

Scheduled payments of capital lease obligations are as follows (in thousands):

Years ended June 30	
2017	12,150
2018	8,300
2019	4,913
2020	4,917
2021	2,653
2022 and later	19,928
Total	52,861
Less amount representing interest	(8,104)
Present value of net minimum lease payments	$ 44,757

Capital lease obligations are at varying rates of imputed interest of 0.0% to 4.45%.

10. LONG-TERM LIABILITIES – OTHER

Other long-term liabilities as of June 30, 2016 and 2015 are summarized as follows (in thousands):

	2016			
	Beginning Balance	Additions	Reductions	Ending Balance
Refundable deposits	$ 10	$ -	$ -	$ 10
Unearned compensation	1,081	-	870	211
Workers compensation	142	-	82	60
Noncurrent construction retainage	60	-	30	30
Noncurrent unamortized bond premium	36,716	-	4,116	32,600
Long-term liabilities - other	$ 38,009	$ -	$ 5,098	$ 32,911

	2015			
	Beginning Balance	Additions	Reductions	Ending Balance
Refundable deposits	$ 17	$ -	$ 7	$ 10
Unearned compensation	822	259	-	1,081
Workers compensation	-	142	-	142
Noncurrent construction retainage	-	60	-	60
Noncurrent unamortized bond premium	4,448	32,910	642	36,716
Long-term liabilities - other	$ 5,287	$ 33,371	$ 649	$ 38,009

11. DESIGNATIONS OF UNRESTRICTED NET POSITION

Unrestricted net position is designated for specific purposes by action of the University's Board of Trustees or management or may otherwise be limited by contractual obligations. Commitments for the use of unrestricted net position at June 30, 2016 and 2015 are as follows (in thousands):

	2016	2015
Working capital requirements	$ 311,171	$ 250,541
Future capital expenditures	319,123	315,063
Total	$ 630,294	$ 565,604

12. INVESTMENT INCOME (LOSS)

Components of investment income (loss) for the years ended June 30, 2016 and 2015 are as follows (in thousands):

	2016	2015
Interest and dividends earned on endowment investments	$ 3,112	$ 2,850
Realized and unrealized gains and (losses) on endowment investments	(6,730)	2,570
Interest and dividends on cash and non-endowment investments	1,466	(569)
Realized and unrealized gains and (losses) on non-endowment investments	(12)	(14)
Total	$ (2,164)	$ 4,837

13. PROGRAM FOR INDIGENT CARE AND CHARITY CARE

The System is reimbursed for uncompensated care, including indigent care, by the Commonwealth based upon available Disproportionate Share System funds. The amounts are included in net patient service revenues and summarized below (in thousands):

	2016	2015
Revenue from the Commonwealth of Kentucky	$ -	$ 9,715
2.5% tax paid by the System on patient cash receipts	(11,756)	(11,756)
Matching contribution paid by the System	-	(2,931)
Net amount received (paid) included in net patient service revenues	$ (11,756)	$ (4,972)

The amount of charges forgone for services and supplies furnished under the System's charity care policy aggregated to approximately $31.5 million and $24.5 million in 2016 and 2015, respectively. As a result of health care reform, the System is seeing a reduction in the amount of charity care as more Kentuckian's are enrolled into Medicaid.

14. PLEDGED REVENUES

The University has substantially pledged all of the unrestricted operating and nonoperating revenues, including the System revenues, to repay the general receipts bonds and notes issued during 2005 to 2015. Only the General Receipts 2007 Notes Series A and B, General Receipts 2009 Bonds Series B, General Receipts Bonds 2014 Series D and General Receipts Bonds 2015 Series A and B are reflected as the System debt. Proceeds from the bonds and notes provided funding for the construction of the new patient care facility and the refunding of previously issued notes. The bonds and notes are payable from unrestricted operating and nonoperating revenues and are payable through 2045. Annual principal and interest payments on bonds and notes are expected to require less than three percent of pledged revenues. The total principal and interest remaining to be paid on the bonds and notes is $670.1 million and $701.9 million in 2016 and 2015, respectively. Principal and interest paid for each of the years ended June 30, 2016 and 2015 was $30.1 million and $24.6 million, respectively.

15. RETIREMENT PLANS

Regular full-time employees of the System are participants in the University of Kentucky Retirement Plan, a defined contribution plan. System employees participate in one of the following three groups of the University of Kentucky Retirement Plan:

Group I	Established July 1, 1964, for faculty and certain administrative officials.
Group II	Established July 1, 1971, for staff members in the clerical, technical and service categories.
Group III	Established July 1, 1972, for staff members in the managerial, professional and scientific categories.

Participation in these groups of the University of Kentucky Retirement Plan is mandatory for all regular full-time employees age 30 and older. Participation is voluntary until age 30. The System contributes 10 percent and each employee contributes five percent of eligible compensation. All payments are vested immediately for employees hired prior to January 1, 2010. For employees hired after January 1, 2010, employer contributions are vested after three years.

The University has authorized two retirement plan carriers, as follows:

Teachers Insurance and Annuity Association (TIAA)
Fidelity Investments Institutional Services Company

In addition to retirement benefits provided from the group retirement plan, the University provides supplemental retirement income benefits to certain eligible employees of the University.

The total contributions charged to operations for the various retirement plans were approximately $29.7 million and $26.3 million for the years ended June 30, 2016 and 2015, respectively. Employees contributed $14.9 million and $13.1 million during 2016 and 2015, respectively. The payroll for employees covered by the retirement plans was $297.3 million and $262.7 million for 2016 and 2015, respectively.

16. HEALTH INSURANCE BENEFITS FOR RETIREES

The University administers a single-employer defined-benefit healthcare plan including medical and prescription drug benefits. The plan provides lifetime healthcare insurance benefits for eligible retirees and their surviving spouses. Human Resources Policies and Procedures define retiree health benefits and can be amended by the President of the University as delegated by the University's Board of Trustees.

The University provides a pre-65 credit of up to 90% of the “true retiree” cost of the least expensive pre-65 medical plan. For post-65 benefits, the University provides a credit equal to 90 percent of the “true retiree” cost of the post-65 medical plan. However, retirees must pay the greater of $25 per month or 10% of total plan cost.

The University has established a trust fund to segregate plan assets, and currently plans to contribute amounts to the trust fund sufficient to fully fund the annual required contribution, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45.

As an organizational unit of the University, the System has recognized its share of the contribution in employee benefit costs and has no additional liability for this benefit at June 30, 2016.

17. RISK MANAGEMENT

The University, of which the System is an organizational unit, is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by (1) the State Fire and Tornado Insurance Fund (the Fund), (2) Sovereign Immunity and the State Board of Claims, or (3) in the case of risks not covered by the Fund and Sovereign Immunity, commercial insurance, participation in insurance risk retention groups or self-insurance.

The Fund covers losses to property from fire, wind, earthquake, flood and most other causes of loss between $1,000 and $1.0 million per occurrence. Losses in excess of $1.0 million are insured by commercial carriers up to $1.25 billion per occurrence. Buildings and contents are insured at replacement cost. As a state agency, the University is vested with Sovereign Immunity and is subject to the provisions of the Board of Claims Act, under which the University's liability for certain negligence claims is limited to $200,000 for any one person or $350,000 for all persons damaged by a single act of negligence. Claims against educators' errors and omissions and wrongful acts are insured through a reciprocal risk retention group. There have been no significant reductions in insurance coverage from 2015 to 2016. Settlements have not exceeded insurance coverage during the past five years.

The University and its agents are insured against medical malpractice by a combination of Sovereign Immunity, self-insurance, commercial liability insurance, and an excess coverage fund established by the Commonwealth of Kentucky. An actuarial valuation is performed to determine the self insurance funding requirements and the fund liability, which has been discounted using an interest rate of three and a half percent. The malpractice liability at June 30, 2016, is based on the requirements of GASB Statement No. 10, which requires that a liability for claims be recorded if it is probable that a liability has occurred and the amount of loss can be reasonably estimated. The liability includes an estimate for claims that have been incurred but not reported at June 30, 2016. All assets and liabilities related to medical malpractice are recorded in the financial records of the University and, accordingly, no assets or liabilities related to medical malpractice are recorded on the System’s financial statements. However, the System does fund its required share of the actuarially determined medical malpractice expense.

The University is self-insured for the long-term disability income program and has established a 501(c)(9) trust for purposes of paying claims and establishing necessary reserves. The University currently plans to contribute amounts to the trust fund sufficient to fully fund the annual required contribution of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. As an organizational unit of the University, the System has recognized its share of the contribution in employee benefit costs and has no additional liability for this benefit at June 30, 2016.

The University also self-insures certain employee benefits, including health insurance, worker's compensation and unemployment claims. The University has recorded an estimate for asserted claims at June 30, 2016.

18. TRANSACTIONS WITH RELATED PARTIES

Due to the nature of the relationship of the System with the University, the System has substantial transactions with the University, including purchases of various supplies and services. Additionally, the University and its affiliates provide certain administrative support functions to the System. The System paid approximately $14.6 million and $10.0 million respectively in 2016 and 2015 to the University as reimbursement for various educational and support functions. The System also recognized income from the University for providing medical services to employees under a capitation health plan. During 2016 and 2015, the System received payments of approximately $31.1 million and $26.8 million, respectively, from the University for the capitation health plan. During 2015 the System received funds from University of Kentucky Research Foundation Inc. from the sale of Coldstream Laboratories, Inc. of approximately $12.4 million included in transfers and approximately $2.7 million in repayment of notes receivable.

19. RECLASSIFICATIONS

Certain reclassifications to fiscal year 2015 comparative amounts have been made to conform to the fiscal year 2016 financial statement classifications. Such reclassifications had no effect on the change in net position.

University of Kentucky

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